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UNITED STATES OF AMERICA
SURFACE TRANSPORTATION BOARD

EX PARTE NO. 582 (SUB-NO. 1)

MAJOR RAIL CONSOLIDATION PROCEDURES

REPLY COMMENTS OF EDISON ELECTRIC INSTITUTE

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REPLY COMMENTS OF EDISON ELECTRIC INSTITUTE

Edison Electric Institute ("EEI") hereby replies to the opening Comments of various parties, including those of the U.S. Department of Transportation ("DOT"), Association of American Railroads ("AAR"), Burlington Northern-Santa Fe Railway Company ("BNSF"), Canadian National Railway Company ("CN"), Canadian Pacific Railway Company ("CP"), CSX Transportation, Inc. ("CSX"), Kansas City Southern Railway Company ("KCS"), Norfolk Southern Railway Company ("NS"), Texas-Mexican Railway Company ("Tex Mex"), and Union Pacific Railroad Company ("UP"). We do not reply to Comments of parties EEI supports, in the interests of brevity.

Introduction and Summary

EEI explained in its Opening Comments filed November 17, 2000 that the proposed rules would appear to permit any conceivable Class I railroad merger, acquisition, or control transaction so long as the application satisfies the informational requirements the Board is also proposing, because merger applicants in all recent merger proceedings have claimed that their proposed transaction would enhance competition and assure adequate service. EEI also explained that it must be assumed that the first merger transaction announced after the Board's new rules take effect will trigger other mergers. Nothing in the Comments filed by any of the railroad parties or any other party gives any reason to question these conclusions.

Instead, the railroads' Comments quarrel with the pro-competitive parts of the Board's proposed rules, but attempt to assuage shipper concerns about service by acceding to the Board's proposal for service assurance plans without agreeing to financial penalties or any other meaningful remedy for inadequate service. The railroads' Comments, by and large, do not contribute much to achieve the Board's policy goals, but rather give lip service to some of what the Board said while interposing objections to the implementation of most of the Board's proposals.

DOT helpfully agreed with several other parties, mostly non-railroad parties, including EEI, that the proposed rules are not sufficiently specific, and do not respond to prior submissions. As a result, we do not know whether prior Comments have been accepted or rejected. To take one example, the Board proposed to require merger applicants to list "3 to 2" shipper parties, but did not say that such parties would be protected. While railroads object -- incorrectly, in EEI's view -- to the Board's policy to enhance competition in rail mergers, it is not clear whether the Board will actually protect "3 to 2" shippers, so it is not clear what, if anything, is the railroads' objection.

DOT also supports financial penalties for service failures resulting from Class I railroad mergers. EEI agrees with those Comments. They are consistent with EEI's Opening Comments.

Of great importance, BNSF submitted a Verified Statement and Comments contending that the Board should consider FERC's merger policy for electric utilities as a useful analogy. EEI agrees with BNSF that FERC's merger policies are an appropriate analogy for the Board to consider in this proceeding. Under FERC's merger rules, electric utility mergers enhance competition because no electric utility may merge without already having filed an open-access tariff that enhances competitive alternatives for the merged utility's customers and other electric users. Were the railroads to agree to specific pro-competitive conditions on mergers, we expect that mergers could proceed expeditiously. BNSF also mischaracterizes FERC's policy by contending that FERC mostly considers competitive effects, not rates. Merger applicants at FERC know that FERC requires utilities to protect ratepayers from merger-related rate increases and does not permit utilities to recover the acquisition premiums paid in such transactions. So many such applicants propose rate decreases or rate freezes on their own, and FERC adopts those proposals. Finally, FERC merger proceedings involving two electric utilities can, as a matter of fact, take longer than BNSF's estimates. BNSF's estimates relied on an average length of time that includes many transactions that bear little resemblance to a merger of two Class I railroads.

While much of what the railroads proposed was predictable hand-wringing, one comment in particular, made by several railroads, is particularly objectionable. The railroads propose that rail merger proceedings be decided much more quickly, indeed in as few as six months, notwithstanding the statutory deadline of 15 months plus one month for initial review of such applications. They refer to the time that other agencies take to review mergers, such as DOJ, FTC, and FERC. But there are many differences between the authority of those agencies and the authority of the STB, and also between the remedies those agencies order. For example, DOJ and FTC routinely order divestitures in appropriate circumstances, making unnecessary the consideration of individual facilities served by the divested properties, whereas the STB has never ordered divestitures to resolve competitive concerns. Moreover, the STB has broad and exclusive authority over labor, competition, and public interest considerations, whereas other agencies do not have such broad or exclusive authority. If the railroads truly believe that their mergers will have beneficial impacts in terms of lower rates and better service, they should be willing to guarantee those results through rate freezes and service guarantees. As we have stated, were they to do so, it might be easier to expedite mergers, as FERC has. Indeed, any future merger proceeding is likely to be larger than any previous transaction before the STB or the ICC, and require more time, not less, to complete. The Board can distinguish the time-consuming transactions from those that would not be so time-consuming without imposing a strait jacket on itself to decide merger proceedings in nine months or less.

One or more railroads complained about virtually every aspect of the Board's proposals. For example, CSX objects to service assurance plans if they are "static" instead of a "process." This seems to set up an endless regulatory argument with shippers, rather than a commitment to pay shippers for service failures, such as all other industries are obliged to do. AAR objects that there is no evidence to support the objective of "enhancing competition" in a particular transaction, but this proceeding is not the place to decide future transactions. The Board does not need evidence of future proceedings to change its policies, and other agencies, such as FERC, have adopted a policy of enhancing competition without deciding the application of that policy to a particular transaction.

EEI supports the Board's proposal to consider the "downstream impacts" of any approval of the merger transaction before it. The railroads' opposition to that proposal is not well-reasoned. While it may be true that it is not absolutely clear which mergers will occur after the next transaction to come before the Board, it is clear that the approval of even one more merger of two Class I railroads will lead, inevitably, to only two Class I railroads in North America.

EEI supports the proposal to have the Board, rather than its Staff, approve any voting trust proposal before a Class I railroad may acquire a controlling interest in another Class I railroad. The approval of a voting trust is the "point of no return" after which, as a practical matter, it is almost impossible to deny an application for approval of a merger of two Class I railroads. As such, it is certainly important for the Board to be involved in approval of the voting trust.

Argument

I.

THE BOARD MUST RESPOND TO ALL IMPORTANT COMMENTS.

In its Opening Comments, EEI urged the Board to respond to the important comments made by each party, which the Administrative Procedure Act requires.[1] *E.g., American Mining Congress v. EPA*, 907 F.2d 1179, 1188 (D.C. Cir. 1990), *citing ACLU v. FCC*, 823 F.2d 1554, 1581 (D.C. Cir. 1987), *quoting Home Box Office, Inc. v. FCC*, 567 F.2d 9, 35 n.58 (D.C. Cir. 1977), *cert. denied*, 485 U.S. 969 (1978). EEI reiterates that obligation, whether it is to respond to the railroads' comments, DOT's, or those of EEI and the shipper interests, so that the final rules are not vulnerable to challenge by any party, including the railroads.

II.

RAILROAD MERGER PROCEEDINGS COULD BE EXPEDITED IF RAILROADS ACCEPTED PRO-COMPETITIVE MERGER CONDITIONS AND STRINGENT SERVICE GUARANTEES.

FERC proceedings are premised on enhancement of competition and assurance of customer protections, including from rate increases. The railroads are trying to shift to shippers the risks in those transactions. The risk of failure in such transactions remains were it belongs, with the merging entities.

A. Time for Completion of Merger Proceedings. EEI believes that the suggestion by some railroad parties that merger proceedings be concluded within as few as six months[2] is, frankly,

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[1] Other parties have urged the same. See, e.g., Comments of the Montana Wheat & Barley Committe, et al., at 1-2.

[2] See, e.g., Tex-Mex Comments at 4-5.

completely unrealistic and not supported by the analogies to such things as FERC merger proceedings.[3] As the attached Verified Statement of Edward H. Comer, Esq., Vice President and General Counsel of EEI, shows, BNSF's contention is not supported by the evidence presented. Many of the mergers included in the average raised few if any competitive or other significant issues and were approved quickly. Those FERC proceedings that are at all analogous to mergers of Class I railroads, such as those between large electric utilities covering large sections of the Nation, have taken periods of time comparable to those of mergers involving Class I railroads. Moreover, FERC adopted a policy requiring electric utilities to provide open-access transmissions as a condition of the merger in order to mitigate any market power that could result from the combination of transmission lines.[4] Significantly, the FERC adopted this policy before it required all utilities under its jurisdiction to provide open-access transmissions. Because utilities provide open-access transmission, one of the central competitive issues presented by a merger of two utilities is eliminated, thus enabling the FERC to process mergers more quickly. Both the Board and the railroads oppose requiring railroads to provide open-access to their captive customers. For this reason, as well as others detailed in Mr. Comer's Verified Statement, the analogy to FERC's handling of utility mergers does not support the argument that the Board can reduce the time it takes to process a merger of two Class I railroads. More importantly, the analogy to FERC merger policy shows that the STB can shorten the time it takes to approve mergers by approving railroad mergers when the railroads are willing to take measures that would enhance, not just preserve, competition.

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[3] See, e.g., BNSF Comments at 17-22.

[4] See *El Paso Electric Co. and Central and SouthWest Services Inc.*, 68 F.E.R.C. ¶ 61,181 at 61, 914-15 (1994).

Moreover, FERC has eliminated the need to consider whether an electric utility mergers have public benefits that will offset the costs of such a transaction by putting the risks of such transactions on the merging entities. For example, FERC assures that rates will not increase as a result of such transactions by requiring such assurances up front. With such commitments up front, and under a competitive regulatory regime to start with, issues of the sort that shippers, ports, communities and shortlines raise in railroad merger proceedings are not typically raised in FERC electric utility merger proceedings because there is no need to do so. For these reasons, it is hardly surprising that FERC proceedings could occur in less time than railroad merger proceedings; the only surprise is that, even with those differences, some FERC proceedings have taken as much time as recent Class I railroad merger proceedings.

For the most part, the railroad industry has a very bad record in the last several years of operating the merged railroads that the ICC and STB have allowed. The industry has promised that such mergers would be pro-competitive and would improve (or at least not degrade) service, while putting more traffic on the rails and off the highways. Generally, those promises have not come true. Surely, this is not a record from which the Board could conclude that even larger transactions should be evaluated in substantially shorter time periods than before.[5]

Congress addressed this issue in the ICCTA and set the deadline for consideration of railroad mergers at 15 months following notice of acceptance of the application (which, in turn, follows a minimum 3-month pre-filing period). Congress is presumed to know what an appropriate time was

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[5] EEI does not suggest that a relatively minor transaction could not be concluded in less than nine months. A recent merger of shortline holding companies was concluded in a few months. Even the CN/IC merger was concluded well within the statutory deadline. EEI simply objects, in advance, to the Board imposing on itself a nine-month or shorter deadline on mergers of Class I railroads, especially because they are likely to be transcontinental mergers.

to conclude such a proceeding. The railroads have offered no good reason why the rights of other parties should be limited or denied by such a short time frame for consideration of a merger application, but that is exactly what a 6- or even a 9-month deadline would cause. Shippers need time to consider intervention, retain counsel, review an application, conduct necessary discovery, submit comments and evidence after the completion of such discovery, respond to responsive applications (or even submit them), defend discovery, file briefs, and present oral argument before the Board. Each of these steps takes time, and they are magnified when railroads resist relevant discovery and must be ordered to produce relevant information (as happened in the Conrail proceeding, for example, when EEI members sought significant discovery from Conrail, CSX, and NS, but were denied much of it, and had to pursue that evidence through several motions, arguments and appeals to the Board).

The railroad parties who have suggested such limited time frames have not even suggested how all of these steps are to be accommodated in such proceedings, while other matters are inevitably also transpiring. The only argument that the railroads make is that a merger that produces public benefits should not be delayed, but given the permanence of such transactions, and the terrible service record of much of the railroad industry in recent years after mergers, the Board should be more concerned about approving a bad merger than about taking enough time to determine if a merger is, on balance, in the public interest, unless the conditions requiring the enhancement of competition and protection of shippers from rate increases and inadequate service are imposed on the railroads.

B. Service Guarantees. A clear risk of a merger is that service may deteriorate. Mergers could be expedited if railroads agreed to financial penalties for service failures. To its great credit, DOT contends that "service assurances" should be "service guarantees," and that, pursuant to those guarantees, railroads should be required to pay compensation to shippers for service failures.[6] The railroads, however, oppose any such remedy.[7][8]

The history of recent mergers teaches that only way to provide shippers with good service is to create financial incentives for railroads not to fail to provide such service. When CSX and NS provided service that was clearly inferior to that provided by Conrail, shippers have sought relief from the Board, and the Board has tried to encourage railroads to improve. But it has not been able even to get service back to, or even close to, the level provided by Conrail. So, too, when UP had its service crisis, it was sued by many shippers. While some shippers recovered under contractual remedies, UP apparently settled most such actions, but the settlements are confidential. Those settlements cannot be cited as proof that such a regime is adequate, because the amounts paid or the other compensation provided shippers are not a matter of record, nor is the relationship of those remedies to the harms alleged or proven. Studies in such places as Texas, however, quantified harms

[6] Comments at 8-9. Many other parties have urged similarly, including: The National Grain and Feed Administration (Comments at 12); The National Industrial Transportation League (Comments at 22); Weyerhaeuser Co. (Comments at 7); Farmrail System, Inc. (Comments at 8-9); and the Oklahoma Department of Transportation (Comments at 11).

[7] UP's Comments contain the peculiar argument that the Board should not rely on bilateral agreements as a mechanism for assuring service because this would give shippers undue leverage. UP Comments at 10-11. That seems quite at odds with the railroads' usual argument extolling the virtue of contracts. Perhaps UP is concerned that such agreements would give shippers an enforceable remedy in the event that the railroad fails to abide by the agreement; it is hard to conceive of any other objection to a private-sector solution of the sort that the Board encourages. In any event, if UP is merely seeking to avoid giving shippers an enforceable remedy, that is eloquent testimony to the inadequacy of the current regulatory regime to provide such assurances.

[8] NS Comments at 40-45; BNSF Comments at 46-49; UP Comments at 10-11.

to shippers and the Texas economy in the billions of dollars, and there is no evidence anywhere of which EEI is aware that UP's payments to shippers even approached that level.

It therefore follows that, except for agreed-upon contractual remedies over which the Board has no jurisdiction, shippers have not been adequately compensated for service failures, despite the Board's best efforts. Surely, for example, neither NS nor CSX has yet provided service equal to that provided before the Conrail "split," yet shippers who have complained to the Board were first required to seek informal relief. EEI is not aware of any record or other public evidence that such informal relief has fully compensated shippers for such failures. So, again, it must be concluded that such remedies are inadequate to restore service to prior, adequate levels, since that service has not yet recovered. Something else must be done to force the railroads to provide adequate service.

Inadequate service for events caused a service provider (and not brought on by a force majeure or other excusable event) is generally the basis for liability at common law. Typically, such liability compensates the customer for the harm caused by providing service at an inadequate level, as compared to a reasonably adequate level of service based on historical records or an objective standard if such is ascertainable. Effectively, however, railroads are insulated, under current circumstances, from being required to provide relief except insofar as that they have agreed to pay under transportation contracts. For captive shippers, such inadequate service merely transfers the railroad's obligations to the shipper, who must stockpile more of the commodity being shipped, or must acquire more railcars, or must buy substitute products, or who loses sales, because captive shippers cannot, by definition, obtain alternative transportation service for the commodity transported by the railroad.

In this sense, financial remedies for shippers whose service is inadequate merely puts the shipper in the position he would be if he had competitive alternatives. This is appropriate, because regulation is supposed to be a substitute for competition. In a competitive circumstance, a shipper who has competition would merely switch to that competitor, and avoid the financial harm caused by the other transportation service provider. (If the shipper incurs higher costs by switching transportation service providers, it should be thought of as not fully competitive, and thus entitled to some relief, in proportion to its increased costs.) Thus, financial penalties would provide shippers with "competitive" remedies, as the Staggers Act promised them 20 years ago.

Moreover, the purpose of requiring railroads to pay shippers compensation for inadequate service is also to induce railroads to improve service to adequate levels. No one has identified any other effective remedy to accomplish that result. Clearly, shippers are entitled to adequate service, and it follows that the only available remedy to accomplish that result is the remedy that the Board must adopt, or shippers will be doomed to inadequate service levels indefinitely.

III.

THE BOARD SHOULD ENHANCE COMPETITION IN RAIL MERGERS.

The railroad parties argue that the Board should not enhance competition in railroad mergers.[9] Their position is inconsistent with their reliance on the pro-competitive policies of the Staggers Rail Act of 1980. The Act states, in its first clause of the "Rail Transportation Policy," that "In regulating the railroad industry, it is the policy of the United States Government ... to allow, to

[9] UP Comments at 12-13; AAR Comments at 7-18; NS Comments at 12-16; BNSF Comments at 23-32; CN Comments at 11-15.UP Comments at 12-13; AAR Comments at 7-18; NS Comments at 12-16; BNSF Comments at 23-32; CN Comments at 11-15.

the maximum extent possible, competition and the demand for services to establish reasonable rates for transportation by rail...."

It is particularly ironic that AAR and UP should argue that the Board does not have authority to enhance competition, because they have relied on that very part of the Rail Transportation Policy to attempt to sustain their position in the D.C. Circuit in their assault on the Board's determination in Ex Parte No. 627 to reject product and geographic competition from determinations of market dominance in rate proceedings. *AAR v. STB*, No. 99-1354, *et al.*

It is also ironic that BNSF relies so heavily on FERC's policy for electric utility mergers, because FERC has adopted a policy of enhancing competition in such proceedings. FERC has done so by requiring utility merger applicants to file an open-acces tariff before they are allowed to file an application to merge with another such utility. See Verified Statement of Edward H. Comer, Esq., attached hereto. *El Paso Electric Co. and Central and SouthWest Services, Inc.*, 68 F.E.R.C. ¶61,181 at 61,914-15. FERC's customer-protection approach is so automatic that FERC applicants invariably simply state how they will protect customers either from rate increases that might otherwise occur (especially if acquisition premiums are involved), or even to propose rate reductions to share cost savings with the customers. In contrast, customers have never asked the Board for rate reductions in rail mergers, but have merely asked to be protected from rate increases. Unfortunately, the Board has declined to do that, and the issue is on review of Decision No. 89 in Finance Docket No. 33388 in the Conrail appeals in the Second Circuit.[10] If the Board adopted pro-competitive

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[10] EEI urges the Board to consider reversing that policy, and to seek a voluntary remand from the Second Circuit of the NIT League petition for review that raises that issue. The Board would earn the accolades of shippers for expressing a willingness to reconsider its decision not to impose shipper rate protections in the Conrail proceeding. Other agencies seek such voluntary (continued...)

conditions of the sort used by FERC then it may be possible to adopt the railroads' suggestions for drastically shortened time frames for reviewing Class I railroad mergers.

In the Staggers Act, as recodified in the ICCTA, Congress understood that railroad mergers could be anti-competitive, and instructed the ICC to continue to protect competition as a result of such mergers, despite the deregulatory character of much of the Act. 49 U.S.C. § 11324. Moreover, the Act clearly indicated that Congress preferred competition to regulation, and the Policy quoted above expresses that approach. The Board is, therefore, under a duty to promote competition where possible, and the Board's expressed intent to do so in rail mergers is therefore both commendable and consistent with Congressional intent expressed in the Staggers Rail Act.

Despite the ICC's and the Board's policy to preserve competition in rail mergers, rail mergers have in fact reduced competition. This has occurred in a variety of ways, as has been set forth at great length by many parties to this proceeding. Examples of the causes of this problem include: competitive conditions that have not always succeeded, the fact that divestitures have not been ordered, and the fact that parties adversely affected have not always participated in such proceedings (so that their interests have not usually been protected, except by happenstance). [11] Moreover, the

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[10](...continued)
remands when they are reconsidering prior policy, as the Board arguably is here through its reconsideration of the "one-lump theory" and related matters.

[11] EEI also has raised its concern that the BNSF trackage rights over 4000 miles of UP track, as a result of the UP/SP merger in Finance Docket No. 32760, have not recreated the competition that SP provided UP in the Central Corridor but which appears to have been lost as a result of that merger. EEI filed a request for more information from UP and BNSF in Finance Docket No. 32760 (Sub-No. 21), so it will not address that separate matter here, except to say that the information EEI was there seeking may be highly relevant to the Board's consideration of issues in this proceeding. EEI is disappointed that the Board did not even want to know the answers to the questions EEI posed.

mere expansion of geographical reach of Class I railroads has reduced competition by preventing railroads serving a portion of a haul to serve the shipper after the merger due to the pricing or other behavior of the merged railroad. This is the evidence that the Board has rejected in favor of its "one-lump theory," but which the Board is willing to reconsider in this proceeding. Of course, shippers cannot prove that the theory is inapplicable in this proceeding, because the evidence that the theory is not applicable is only available from the railroads in the merger proceeding in which the issue is raised and the evidence presented after discovery.[12]

It is therefore necessary to restore at least some of the competition that has been lost. The Board's policy to enhance competition in rail merger proceedings is thus an appropriate response to the effects of prior mergers. The Comments of the railroads on this subject should be rejected, and the Board's proposal to require that competition be enhanced as a result of Class I railroad mergers should be adopted.

[12] In this respect, EEI supports the Board's proposal to require the availability of the 100% traffic tapes in each future rail merger proceeding, for that information is important, if not essential, to proving that the "one-lump theory" does not apply. In order for the information to be useful to a shipper or other party seeking to prove that the "one-lump theory" does not apply, though, the Board needs to ensure that shipper witnesses have the actual, not the masked, actual revenues/rates on the tape, because the shipper would be trying to prove that the rates charged are subject to increase as a result of a merger. By definition, a party requires the actual rates in order to make a rate comparison.

IV.

THE BOARD SHOULD ADOPT FERC'S APPROACH TO ENSURING PROTECTION FROM RATE INCREASES AFTER MERGER TRANSACTIONS.

BNSF advocates that the STB should look to FERC's electric utility merger policy as a model for the merger policy it adopts in this proceeding. However, BNSF does not set out the whole of that policy, nor the context in which the FERC's merger policy applies.

First, BNSF claims that FERC mostly concentrates on competition, and not rates, in its approach to electric utility mergers. While that may appear to be true from FERC's decisions, it is only so because FERC has made it abundantly clear that customers may not be subject to rate increases as a result of mergers, and that acquisition premiums can never be passed through to customers. Accordingly, utility merger applicants propose rate freezes or rate reductions, which FERC routinely endorses. That is why the decisions do not dwell on rate issues. The Board should adopt such customer rate protections in railroad merger proceedings, as FERC does in utility merger proceedings.

Second, while FERC does concern itself with competition in electric utility mergers, as BNSF claims, the full story is even better for customers than BNSF claims. That is because FERC will not approve such a merger of utilities unless they provide open-access transmission, if the utilities are still operating transmission and distribution facilities. *See* Verified Statement of Mr. Comer. So FERC's policies, with respect to both mergers and competition, enhance competition. Since the STB does not have a comparable "open access" policy (and shippers are not advocating that), the Board must enhance competition in rail mergers in order to track FERC's policies, as BNSF advocates.

V.

THE BOARD SHOULD CONSIDER DOWNSTREAM IMPACTS.

Various railroad parties take the position that some or all "downstream effects" of railroad mergers should not be considered. CN, for example, opposes the proposed rules if they constitute a requirement that hypothetical downstream effects be taken into account.[13] AAR argues that the Board cannot require precision in predicting the benefits of a proposed merger in light of anticipated downstream effects.[14] UP, on the other hand, argues that the Board should consider downstream effects but should not focus on "likely" specific transactions.[15] UP advocates instead that the Board require consideration of a two-Class I-railroad industry. NS argues that the Board should not require applicants to measure merger benefits in light of anticipated downstream mergers.[16]

Some railroad parties also contend that the Board should not adopt "springing conditions," i.e., those that take effect only if downstream mergers occur.[17]

The railroads are wrong on both counts. First, it will be as clear as it can possibly be, once the first merger transaction of an Eastern or Western carrier occurs, what other transactions are quite likely. If UP proposes to merge with CSX, for example, or BNSF with NS, it will be clear that each Eastern carrier will not thereafter merge with the other Western carrier, and vice versa. Even if that were not so clear, the shippers' concern is not, in many respects, with which railroads merge, as that

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[13] Comments at 16-20.

[14] Comments at 22-23.

[15] Comments at 3-5.

[16] Comments at 51-52.

[17] AAR Comments at 22-23; UP at 3-5.

there will be a two-railroad industry in North America, as UP's Comments, and the "Open Letter to Railroad Customers" attached to EEI's Opening Comments demonstrate. The Board's rules should be adequate to respond to such a scenario, for the Board's perceived need for "balanced rail competition" requires a two-railroad outcome if even one more merger is approved two Class I railroads.

It follows, therefore, that the Board should stick to its guns and require consideration of "downstream effects" and "downstream mergers," regardless of which railroads first propose to merge. For example, a transcontinental merger is likely to cause service problems, as have occurred in gateways and major interchanges in many recent mergers. Recent service problems seem due not only to specific mergers, but also to the gargantuan size of the current Class I railroads.[18] The need for service assurances is, therefore, as great regardless of the two Class I railroads whose merger is first proposed.

So, too, is there a need for pro-competitive conditions, regardless of the two Class I railroads involved, in order to produce the promise of the Staggers Rail Act to promote competition in lieu of regulation. If there is no other agreement of nearly all parties to this proceeding, there is one near-consensus of railroads and shippers, as well as other parties: competition is a better solution than regulation, for many reasons. It is more efficient, less costly, avoids delays, and produces better service at lower rates. It is the preferred approach to every industry in America which can be made competitive.

[18] EEI exempts KCS from its characterization of the size of the other Class I railroads. EEI previously indicated its willingness to allow a merger involving KCS to be considered for exemption from some of the Board's merger rules, depending on the circumstances of the transaction proposed.

VI.

THE BOARD'S VOTING TRUST PROPOSAL SHOULD BE ADOPTED.

In its proposed rules, the Board proposed that its Staff would no longer approve voting trusts, but rather those would be approved only by the Board itself. EEI supported that change in its Opening Comments.

The railroads have various objections to the Board's proposal, but none of them meet the real issue: whether Staff or the Board itself should issue such voting trusts. Clearly, such approvals, which have allowed the railroads to take on billions in debt in such transactions as acquiring Conrail, have as a practical matter been the "moment of no return" in such proceedings, for once the money is spent it is virtually impossible to expect the Board to reverse itself without doing grave financial harm to the railroads. Yet, such acquisitions have often not been in the best interests of railroads, their shareholders, or their customers.

It therefore is, in EEI's view, unarguable that a matter as momentous as taking on billions of dollars of debt to acquire the voting stock of another Class I railroad and put it into voting trust is a matter that should be approved only with the prior approval of the Board itself. Any other issues pale in significance to the issue whether the Board or its Staff make the decision to allow railroads to "pass the point of no return."

Conclusion

Because future rail mergers remain not only permissible, but likely, EEI believes the Nation is headed to a future of two Class I railroads in North America. For that reason, EEI advocates that the Board adopt the proposals made in its Opening Comments, and in these Reply Comments.

Respectfully submitted,

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VERIFIED STATEMENT OF EDWARD H. COMER

1. My name is Edward H. Comer. I am Vice President and General Counsel of Edison Electric Institute ("EEI"). EEI is the association of U.S. shareholder-owned electric companies, international affiliates and industry associates worldwide. EEI's membership currently includes 200 U.S. companies, which serve over 90 percent of all customers served by the shareholder-owned segment of the industry. They generate approximately three-quarters of all the electricity generated by electric companies in the country and service about 70 percent of all ultimate customers in the nation. Many of EEI's members use coal as a fuel for generating electricity and most of this coal is transported by the railroads. In many instances, EEI's members are captive customers of the railroads.

2. Our U.S. members are extensively regulated at both the state and Federal level. At the Federal level, our members are regulated by the Federal Energy Regulatory Commission ("FERC"). The FERC, acting pursuant to the Federal Power Act, 16 U.S.C. §§ 792 et seq., regulates the rates, terms and conditions under which our members may sell electricity at wholesale and transmit electricity in interstate commerce. The FERC also must approve mergers and acquisitions of electric utilities and changes in control over jurisdictional facilities. Most of

EEI's members are also regulated by state public utility commissions, which generally must approve the rates, terms and conditions for retail sales or for distribution of electric energy where retail electric sales have been deregulated. Most of the state commission also must approve mergers and acquisitions of electric utilities.

3. I am submitting this Verified Statement in response to the Opening Comments in this proceeding of The Burlington Northern and Santa Fe Railway Company ("BNSF"), filed on or about November 17, 2000. BNSF urges the Board to reduce the time for processing mergers of railroads to 270 days, or nine months. In support of this substantial shortening in the time for processing such mergers, BNSF argues, among other things, the Department of Justice and the Federal Trade Commission can process mergers in less time than the Board proposes to take to process railroad mergers. BNSF also points out that the FERC was able to improve significantly the time it takes to consider mergers of electric utilities when it narrowed the scope of its merger review and defined more precisely the information applicants must provide in their applications. BNSF urges the Board to do the same. BNSF has sponsored the Verified Statement of Richard J. Pierce, Jr. to support its arguments about the FERC's processing of electric utility mergers. There are significant omissions in Mr. Pierce's description of the FERC's electric utility merger policy. As a result, the analogy BNSF tries to draw between the FERC's electric utility policy to the Board's policy is not just inapt, it is misleading.

4. The FERC issued a major refinement to its electric utility merger policy in December 1996. Order No. 592, <u>Inquiry Concerning the Commission's Merger Policy Under the Federal</u>

Power Act: Policy Statement, III FERC Stats. & Regs. ¶ 31,044.[1] According to Mr. Pierce, since then the average time FERC has taken to process a merger application is 117 days.

The FERC has been able to speed up its review of utility merger applications because it has instituted pro-competitive measures and customer protections that both the Board and the Class I railroads have resisted using the railroad context. Through its merger policy and decisions, FERC seeks to promote competition and requires binding commitments that the merger will not increase customer rates. In addition, the FERC can act more quickly than the Board because the FERC generally is not the sole regulatory authority that has to approve the merger. State regulatory authorities often consider retail service issues the FERC does not, issues which are analogous to issues the Board must consider. Federal agencies, such as the Department of Justice or the Federal Trade Commission and the Securities and Exchange Commission also review utility mergers. Finally, many of the mergers included in Mr. Pierce's average include many mergers that are nothing like a merger of Class I railroads. The FERC has approved these mergers quickly. But when the FERC has confronted a merger of scope and size equal to the scope and size of two Class I railroads mergering, it has taken as long as 22 months to approve the merger.

5. Large, public utilities have traditionally been vertically integrated: they own generating facilities to generate electricity, own transmission lines to carry the electricity over large distances, and own distribution facilities to deliver the electricity to the customer. When two utilities of this type decide to merge, a major issue is whether the combination of transmission lines will make it

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[1] Recently, in Order No. 642, Revised Filing Requirements Under Part 33 of the Commission's Regulations, the FERC revised its regulations to update the filing requirements for applicants seeking approval of their mergers.

more difficult for competing sellers of electricity to reach customers, thus reducing competition. The Board faces similar issues when two Class I railroads merge. And, as is still the case at the Board, these issues used to be a seriously litigated issue at the FERC. But in 1994 the FERC adopted a policy that it could not be sure that the merger applicants had mitigated market power in transmission -- and thus would not approve the merger -- unless the applicants had agreed to provide open access transmission so that their wholesale customers could reach competing sellers of electricity. See El Paso Electric Co. and Central and SouthWest Services Inc., 68 FERC ¶ 61,181, at 61,914-15. With the adoption of this policy, the FERC eliminated one of the major competitive issue it had to consider.[2] Significantly, the FERC established that policy before requiring, in 1996, that all electric utilities under its jurisdiction must provide open access transmission to wholesale customers.[3] The Board has not adopted a similar policy that captive merger applicants must have open access to competing railroads, and for this reason, the question

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[2] The FERC still has to consider whether the merger will increase market power in generation. The FERC has developed detailed analytical screens, based on the Department of Justice Hortizontal Merger Guidelines, for analyzing this question. Applicants provide detailed analyses in their applications using the FERC's analytic screens. The FERC is generally able to resolve the question of whether the merger will increase market power in generation based on the applicants' analysis without the need for extensive discovery or litigation because of the extensive work the applicants do before filing their application with FERC.

[3] Since then the FERC has gone further. For example, in approving the merger of American Electric Power Company and Central and South West Corporation, the FERC required the applicants to transfer operational control of their transmission lines to a FERC approval regional transmission organization (RTO). American Electric Power Co., 90 FERC ¶ 61, 242, at 61,788, reh'g denied, FERC ¶61,129 (2000). An RTO is intended to eliminate the ability of a transmission-owning utility to favor one seller of electricity over another by having an entity operate the transmission lines of a number of utilities, independent of market participants. Although the FERC has issued a role that is designed to encourage all utilities to join RTOs, the FERC has not required utilities to join RTO except as a condition to its approval of a merger.

of whether the market power of railroad applicants will be increased remains a major issue for the Board.

6. The FERC's approach to the question of whether the merger produces sufficient benefits to offset merger related costs and forestall rate increases also differs markedly from the Board's. This issue used to be extensively litigated at the FERC. But when the FERC refined its merger policy, it virtually eliminated the issue. The FERC stated:

> Rather than requiring estimates of somewhat amorphous net merger benefits and addressing whether the applicant has adequately substantiated those benefits, we will focus on ratepayer protection. Merger applicants should propose ratepayer protection mechanisms to assure that customers are protected if the expected benefits do not materialize. The applicant bears the burden of proof to demonstrate that the customer will be protected. This puts the risk that the benefits will not materialize where it belongs -- on the applicants.

Order No. 592, Inquiry Concerning the Commission's Merger Policy Under the Federal Power Act: Policy Statement, III FERC Stats. & Regs. at 30,123. The FERC then outlined four possible forms of ratepayer protections it would consider: (1) a commitment from the applicants to protect wholesale customers from any adverse rate effects resulting from the merger for a significant period of time; (2) a commitment from the applicants to freeze base rates for a significant period of time; (3) a commitment from the applicants to file a rate decrease; or (4) an agreement by the applicants to allow wholesale customers to terminate agreements so that the customers could switch to another supplier.

7. FERC applicants have been willing to make these types of commitments. These commitments invariable include a commitment not to seek recovery of any acquisition premium. See, e.g., Enron Corp. and Portland General Corp., 78 FERC ¶ 61,179, at 61,738-40 (1997)

(applicants commit not to file a rate increase for four years and agree not to seek recovery of the acquisition premium); Duke Power Co. and PanEnergy Corp, 79 FERC ¶ 61,236, at 62,039 (1997) (applicants agree to a four-year rate freeze and to record all direct merger related expenses, including acquisition premium, below the line); PG&E Corp. and Valero Energy Corp., 80 FERC ¶ 61,041, at 61,136 (1997) (applicants agreed to hold ratepayers harmless from merger-related costs by not pushing the acquisition premium and other merger related costs down to operating costs and recording merger-related expenses incurred by the operating companies below-the-line); Illinova Corp. and Dynegy, Inc., 89 FERC ¶ 61,163, at 61,487 (1999) (commitment to hold ratepayers harmless from merger-related costs); Commonwealth Edison Co., 91 FERC ¶ 61,036, at 61,135 (2000) (commitment to hold ratepayers harmless from merger-related costs).[4] Because electric utilities make these commitments, the effect of the merger on rates does not play a major role to the effect of the merger on competition in the FERC's decisions on merger, as Mr. Pierce points out. But this is not because the effect of the merger on rates is unimportant; it is because FERC has established clear policies to protect ratepayers and electric utility applicants follow those policies. This Board has not adopted similar policies to protect captive customers from the possibility of bearing rate increases as a result of the merger of two railroads. The impact of rail mergers on the rates of captive customers thus remains a

[4] In some cases FERC applicants have sought to preserve the right to seek recovery of merger-related costs to extent there are demonstrated merger-related benefits. Unlike the Board's practice, these commitments do not include estimated benefits that are expected to result from the merger; they require an after-the-fact determination that the benefits have been realized. No party has sought to make such a recovery filing.

contentious issue that must be resolved during the Board's processing of mergers, and should, therefore, be addressed herein.

8. Another reason the FERC is able to process merger applications more quickly is that the FERC does not act alone. Electric utilities are not immune from the antitrust laws, as railroads. As a result, either the Federal Trade Commission or the Department of Justice review the mergers of electric utilities independently. The Securities and Exchange Commission and the Nuclear Regulatory Commission may also have to approve the merger. In addition, most traditional electric utilities are regulated by state utility commissions, which as I noted above, regulate the utilities' service to retail customers. Most of these commissions have jurisdiction to approve mergers. Because of this, the FERC considers the effect of the merger on retail customers only in rare instances where there is no state commission with jurisdiction to approve the merger or the state commission requests the FERC to step in. The impact of utility mergers on the ultimate consumer of electricity is similar to the impact of the rail mergers on individual shippers. The Board has to spend a substantial amount of time dealing with these issues. In short, because other agencies are involved, FERC's review of utility mergers is more limited than the Board's is. If the FERC had to resolve these issues, as well all the other issues raised by a merger, as the Board does, the FERC would take longer than it does in approving mergers.

9. As I noted above, FERC's merger jurisdiction extends to any change in the control of a jurisdictional facilities. FERC defines jurisdictional facilities broadly as including any contract for the sale of electric energy, as well as rate schedules for the sale of electric energy. This broad reach of the FERC's merger jurisdiction requires FERC approval of many mergers that have limited regulatory significance under the Federal Power Act. For example, one of the changes

that has occurred in the electric utility industry in recent years is the emergence of trading companies that buy and sell electricity at wholesale. These companies own no generating or transmission facilities and do not have captive customers. They engage in marketing activities by selling electricity at market prices. This marketing activie barely existed as little as five years ago. For these reasons, the FERC has generally found that mergers involving marketing companies do not raise market power or customer rate issues. The FERC is able to approve these mergers quickly.

10. Another trend in the electric utility industry has been an number of "convergence" mergers. These are mergers between an electric utility and a predominantly gas company. The gas company often has a trading company that trades electricity or a small amount of generation. For example, when Duke Power Company, a large generating and transmitting electric utility in the Carolinas, agreed to acquire PanEnergy Corp., which owns and operates transmission lines into the Midwest and into New York and New England, FERC approval was needed because PanEnergy owned a trading company and 16 MW of generating capacity in Louisiana. (In contrast, a typical utility owns several thousand megawatts of generating capacity.) Neither the trading company nor the 16 MW of generation presented any competitive or rate issues, and the FERC approved this transaction quickly. There have been at least nine similar transactions. The FERC has generally been able to approve these mergers quickly because the gas assets involved in the merger have often been remote from generation competing with the electric utility. Thus, these merger are analogous to a merger between a Class I railroad and a non-rail transportation provider operating in a different part of the country, a not a merger between two Class I railroads.

11. Finally, because of the Public Utility Holding Company Act and state requirements, most utilities have been state or regional in scope and represent a far smaller share of the national market than the remaining Class I railroads. Thus, mergers of these traditional utilities oftern have not had the scope of a merger of any of the remaining Class I railroads.

12. In sum, FERC's merger policy is a useful analogy for this Board to consider, especially because it imposes clear, precise requirements for enhanced competition in the form of open transmission access and customer rate protections -- in the form of rate freezes or rate reductions -- before mergers will be approved.

Thus, BNSF's opening comments are misleading in suggesting that, because FERC approves some mergers more quickly than this Board, this Board could do so, too. That does not follow, because (1) FERC has clear-cut ways of protecting and promoting competition and protecting customers from adverse effects of the merger, ways both the Board and the Class I railroads resist adopting, (2) many other agencies must approve utility mergers so that FERC's role in approving utility mergers is more limited than the Board's role in approving mergers of Class I railroads, and (3) many FERC mergers raise many fewer competitive and customers issues than the mergers of Class I railroads.

VERIFICATION

Edward H Comer

Edward H. Comer

Subscribed and sworn to before me

this 14th day of December, 2000.

Donna Mercer-Jones

Notary Public

My Commission Expires:

DONNA MERCER-JONES
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